United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLANT

76-7465

United States Court of Appeals

For the Second Circuit

TRANSCONTINENTAL OIL CORPORATION, TRECON OIL CO. LTD. and B. EDWIN SACKETT, individually and as nominee,

Plaintiffs-Appellees and Cross-Appellants,

—against—

TRENTON PRODUCTS COMPANY, BERNARD FEIN, HERZFELD & STERN, LOEB, RHOADES & CO., GERSTLEY, SUNSTEIN & COMPANY, A. ARTHUR WEISS, LOUIS C. FIELAND and THERESA ZAPPLEY,

Defendants.

TRENTON PRODUCTS COMPANY and BERNARD FEIN,

Defendants-Appellants and Cross-Appellees.

TRENTON PRODUCTS COMPANY and BERNARD FEIN,

Defendants and Third-Party Plaintiffs—Appellants and Cross-Appellees,

—against—

PHILLIP P. GOODKIN, LOUIS GOODKIN, MICHAEL A. ROBERTS, DAVID FRANKEL, JAMES E. DAVIS, PAUL A. ROSSBOROUGH, J. STREICHER & COMPANY, HARRY B. LESLIE, BERTRAM F. FAGENSON, EDWIN B. SACKETT and FAGENSON AND FRANKEL COMPANY, INCORPORATED,

Additional Defendants—Appellees on Counterclaim.

Appeal from a Judgment of the United States District Court for the Southern District of New York

BRIEF OF DEFENDANTS-APPELLANTS TRENTON PRODUCTS COMPANY AND BERNARD FEIN

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TABLE OF CONTENTS

	Page
Preliminary Statement	1
Statement of Issues	1
Statement of the Case	2
Course of Proceedings and Disposition Below	4
The Facts	8
A. Previous Litigation Between the Parties on the Same Issues	8
B. The Desilets Shares	12
(i) Control of Transcontinental in the 1950's	13
(ii) Control of Transcontinental in Late 1959 and Early 1960: The Burkinshaw Regime	14
(iii) Burkinshaw's Frauds Upon Transcontinental and Trenton and Fein	15
(iv) The Issuance of the Desliets Shares in 1960	19
(v) The Embezzlements of Burkinshaw and the Financial Insolvency of Transcontinental from 1960 to 1966	24
Point I. The Second Count of the Complaint Should Have Been Dismissed on the Grounds of Res Judicata, Collateral Estoppel, Release and Limitations	28
A. The Prior Adjudication Between the Same Parties on the Same Claims and Issues Bars the Second Count	28
(i) The Allegations of the Complaints are the Same	28

Page

(ii) The Issues and Claims Presented at Trial are Barred by the Prior Adjudication 30

B. The Statute of Limitations Bars the Second Count 34

(i) The 1970 Amendment Does Not Relate Back 37

C. The Previously Adjudicated and Time Barred Claims and Issues Should Finally be Dismissed 37

Point II. Defendants Rightfully Acquired the Desilets Shares and did not Convert them. Judgment on the Second Count Should Therefore be Reversed 40

Point III. Plaintiffs Failed to Prove Damages on the Second Cause of Action and the Measure of Damages Fixed by the District Court is Clearly Erroneous 47

A. The Damages Awarded by the District Court are Unsupported by the Record . . 47

B. The Award of $35,000 was Made by the Court Upon a Claim Never Asserted by Plaintiffs and Against Which Claim Defendants had no Opportunity to Defend 54

Point IV. Judgment Should Have Been Entered in Favor of Trenton and Fein on their Counterclaims for Plaintiffs' Wrongful Refusal to Permit the Defendants to Transfer their Shares 57

A. The First and Second Counterclaims . . 57

B. The Third Counterclaim 63

Conclusion 66

TABLE OF AUTHORITIES

Cases: Page

Aeroglide Corp. v. Zeh, 301 F.2d 420 (2d Cir.), cert. denied, 371 U.S. 822 (1962) 59

Citizens National Bank v. Osetek, 353 F. Supp. 958 (S.D.N.Y. 1973) 59

Gasarch v. Ormand Industries, Inc., 346 F. Supp. 550 (S.D.N.Y. 1972) 58

Hirsch, 51 T.C. 121 (1968) 52

Husted, 47 T.C. 664 (1967) 52, 53

Kanton v. United States Plastics, Inc., 248 F. Supp. 353 (D.N.J. 1965) 58, 61-63

Klein v. Bower, 421 F.2d 338 (2d Cir. 1970) 34

Kupferman v. Consolidated Research & Mfg. Corp., CCH Fed. Sec. L. Rep. [1961-64 transfer binder] ¶91,197 (S.D.N.Y. 1962) 48, 52

Mariash v. Morrill, 496 F.2d 1138 (2d Cir. 1974) 64, 65

Morissette v. United States, 342 U.S. 246 (1952) 59

Riskin v. National Computer Analysts, Inc., 62 Misc. 2d. 605,308 N.Y.S.2d 985 (Sup. Ct. N.Y. Co. 1970), modified and aff'd, 37 A.D.2d 952,326 N.Y.S.2d 419 (1st Dept. 1971) 58

Rothberg v. National Banner Corp., 259 F. Supp. 414 (E.D.Pa. 1966) 58, 59, 64, 65

Ruskay v. Jensen, 342 F. Supp. 264 (S.D.N.Y. 1972) 32, 33

Page

Siegler v. Living Aluminum Inc., CCH Fed. Sec. L. Rep. [1961-64 transfer binder] ¶91,266 (Sup. Ct. N.Y.Co. 1963) 48, 52, 53

Smith v. Alleghany Corp., 394 F.2d 381 (2d Cir.), cert. denied, 393 U.S. 939 (1968) 33

Specialty Paper & Board Co., 24 CCH T.C. Mem. 1085 (1965) 52

Stella v. Kaiser, 218 F.2d 64 (2d Cir. 1954), cert. denied, 350 U.S. 835 (1955). . . . 34

Statutes, Rules, and Releases:

Section 10(b), Securities Exchange Act of 1934, 15 U.S.C. §78j(b) . . . . . 63 - 65

SEC Rule 10b-5, 17 C.F.R. §240.10b-5 . . . . . 63, 65

SEC Accounting Series Release No. 113, CCH Fed. Sec. L. Rep. ¶72,135 (Oct. 21, 1969) 52

Uniform Commercial Code Sec. 8-401 58

New York Civil Practice Act §48(8) 35

New York Civil Practice Act §49(7) 34, 35

New York CPLR §213 . . . . . 34, 35

New York CPLR §214 34

New York CPLR §218(a) 35

Miscellaneous:

12 Fletcher Cyc. Corp. (perm. ed. 1971) §5523 58

12 Fletcher Cyc. Corp. (perm. ed. 1971) §5524 59

Page

12 Fletcher Cyc. Corp. (perm. ed. 1971)
§5527 59

3 Moore, Federal Practice (2d ed. 1974)
¶15,15 [3] 37

Preliminary Statement

Defendants-Appellants and Cross-Appellees, Trenton Products Company ("Trenton") and Bernard Fein ("Fein")* jointly submit this brief in support of their appeal from the final judgment entered by Hon. William C. Conner, D.J., on August 26, 1976, after a non-jury trial on the issue of liability held in September and October 1974 and a non-jury trial on the issue of damages held on December 8, 1975.

Statement of Issues

1. Having determined that the issuance by Transcon--tinental Oil Corporation ("Transcontinental") of 100,000 shares of common stock ("the Desilets shares") in April 1960 was without consideration and thus void and that the defendants' possession of those shares since 1960 and the transfer of them in 1966 was a conversion, did the District Court err, as a matter of law, in finding that the claim was not barred (a) by res judicata, collateral estoppel and release as a result of the settlement in 1966 of a derivative action between the same parties on the same issues and claims and (b) by the applicable statute of limitations?

2. Was the District Court's finding (a) that the defendants were not the proper owners of the Desilets shares and had converted them, and (b) that Transcontinental had suffered damages as a result thereof of $48,200 with interest, clearly erroneous?

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* Hereinafter sometimes jointly referred to as "the defendants".

3. Having refused to sustain plaintiffs' attack upon defendants' ownership of 550,000 shares of common stock of Transcontinental, which shares plaintiffs have refused to transfer since 1966, did the District Court err, as a matter of law, in finding that the plaintiffs were not liable to the defendants on counterclaims for conversion?

4. Did plaintiffs' refusal to permit defendants to transfer their 550,000 shares of common stock of Transcontinental, coupled with plaintiffs' sale and distribution of millions of shares of Transcontinental common stock, constitute a violation of Section 10(b) of the Securities Exchange Act of 1934 and was the District Court's refusal to so rule clearly erroneous and contrary to law?

Statement of the Case

Between mid-1960 and August 1966 defendants Fein and Trenton were the controlling shareholders of Transcontinental, an insolvent public corporation (A85, 99-101).*

In 1965, plaintiff B. Edwin Sackett ("Sackett"), in an attempt to take over control of Transcontinental, commenced two shareholder actions, for the benefit of Transcontinental, against Fein and Trenton. In those actions Sackett claimed that the defendants had, since 1960, committed acts of waste and mismanagement and had converted large quantities of Transcontinental common stock from the company (A101-102).

Those shareholders actions were settled by the transfer of control of Transcontinental by Fein and Trenton

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* References preceded by the letter "A" are to pages of the Joint Appendix.

to Sackett and a group of investors which he represented (A102-105). A final judgment approving the settlement was entered in July 1966, and releases were obtained by the defendants (A103). Thereafter, in August 1966 Sackett took over control of the company and became its new president. Upon assuming control, and in October 1966, Sackett directed the company's transfer agent to refuse to permit the defendants to transfer any of the remaining shares of Transcontinental common stock which the defendants still owned (A106-107).

Thereafter, and on February 9, 1967, plaintiffs commenced this action by the filing of a ten count complaint, the first eight counts on behalf of Transcontinental and the last two counts on behalf of Sackett (A9-26).

Transcontinental once again alleged that between 1960 and 1966 the defendants had committed acts of waste and mismanagement in the operation of the company. In addition, the defendants were charged with having misappropriated from the company hundreds of thousands of shares of common stock between 1960 and 1966 (A11-12A). Transcontinental sought both damages and an injunction enjoining the defendants from transferring their shares of common stock, which were alleged to have been misappropriated from Transcontinental (A24-25).

In the last two counts of the complaint Sackett sued for breach of contract and fraud in connection with the

agreement whereby he had acquired control of Transcontinental. The primary thrust of his claim was that the defendants had contracted and represented that the 650,000 shares of common stock which he had acquired constituted all of the defendants' Transcontinental stock. He claimed that if the shares still held by the defendants were not converted from Transcontinental, then they should have been delivered to him (A20-23).

In their answer to the complaint, Fein and Trenton denied the allegations of waste, mismanagement, conversion, fraud and breach of contract. Among the affirmative defenses raised by the defendants were limitations and res judicata and release based upon the settlement of the prior derivative action. In addition, defendants alleged three counterclaims for damages resulting from plaintiffs' wrongful refusal to permit the defendants to transfer or sell their remaining shares of common stock of Transcontinental (A28-41).

Course of Proceedings and Disposition Below

Prior to the commencement of the trial on the issue of liability, Transcontinental voluntarily withdrew the Third, Fourth and Eighth Counts of the complaint. In addition, in advance of trial and on motion of the defendants, the District Court dismissed, as res judicata, the Sixth Count for alleged conversion of monies from Transcontinental during the period 1960 to 1966 (A84).

Accordingly, at trial Transcontinental attempted to prove its First, Second, Fifth and Seventh Counts and

Sackett presented proof relating to his Ninth and Tenth Counts. In addition, defendants sought relief on their counterclaims.

In the First Count of the complaint Transcontinental had alleged that defendants had converted 300,000 shares of common stock. At trial, numerous transactions, involving 900,000 shares of stock, were attacked. Judge Conner found all of the claimed conversions to be either without merit or barred by res judicata or both (A111-121).

On the Second Count of the complaint, Judge Conner found (a) that in April, 1960, 100,000 shares of Transcontinental stock were issued without consideration and were thus void; (b) that said shares remained in defendants' possession from 1960 to 1966 and (c) that in August 1966 the defendants transferred the shares to one Louis B. Fieland. Judge Conner conceded that the claims and issues relating to (a) and (b) were res judicata. However, he concluded that the August 1966 transfer was a conversion of shares which should have remained in Transcontinental's possession and been cancelled (A121-124). Transcontinental's damages were fixed at $48,200, with interest, at a separate trial. Defendants' appeal from the judgment entered on the Second Count and contend that they are the rightful owners of the shares in question. Moreover, they urge that the claims and issues raised by the Second Count are barred by limitations, res judicata, collateral estoppel and release.

With a single exception, Transcontinental's claims, in the first two counts of the complaint, that defendants had converted some 1,000,000 shares of Transcontinental stock, were rejected by Judge Conner. He refused to require the defendants to turn over to plaintiffs the 550,000 shares of stock in their possession or to enjoin their further transfer. Nonetheless, he declined to hold plaintiffs liable on defendants' counterclaims for damages suffered as a result of the wrongful stop-order placed against their 550,000 shares. Judge Conner found that defendants failed to prove that plaintiffs were motivated by bad faith in imposing the stop-order and that Sackett's "sincere belief" that he was acting properly was a valid defense to defendants' counterclaims for conversion (A141-145). Defendants contend that they have been damaged by plaintiffs' acts and that plaintiffs' good faith is not a defense to an action for conversion. Therefore, they appeal from the dismissal of their counterclaims.

Finally, Judge Conner

(a) dismissed, as without merit, Transcontinental's Fifth Count relating to defendants' alleged negligence in permitting certain of Transcontinental's oil leases to lapse in 1962 and 1963 (A124-125);

(b) dismissed, as without merit, Transcontinental's Seventh Count relating to defendant Trenton's alleged obligation to pay certain rental fees between 1960 and 1966 (A125-126);

(c) dismissed, as without merit, Sackett's Ninth Count relating to defendant Trenton's alleged breach of contract and misrepresentation that it was selling all of its Transcontinental shares to Sackett (A130-135);

(d) dismissed, in part, and granted in part, Sackett's Tenth Count for breach of a specific warranty, which claim Sackett subsequently withdrew on the eve of the trial on the issue of damages (A136-138).

THE FACTS

A. Previous Litigation Between The Parties on the Same Issues

Between May, 1960 and August, 1966, defendants Trenton and Fein were the controlling shareholders of Transcontinental, and Fein was the company's president from August 12, 1960 to August 12, 1966 (A85). During that period of time, and as a result of frauds perpetrated upon Transcontinental by its prior management, which will be discussed below, the corporation was "without funds, faced with bleak financial prospects, burdened with debt" and in a "dormant and moribund state" (A183).

In 1965, Sackett, a shareholder of Transcontinental, in an attempt to take over the company, commenced two shareholder's actions against Fein and Trenton (A101-102). In the Court of Chancery of Delaware, Sackett sought an order requiring an election to be held for the directors of Transcontinental (A102). In the District Court for the Southern District of New York, he commenced a derivative action against Fein and Trenton and the other officers and directors of Transcontinental. Sackett v. Transcontinental, et al., U.S.D.C., S.D.N.Y. (65 Civ. 2500) (A171-180). In that action, Sackett charged among other things that since January 1, 1960 defendants Fein and Trenton had wrongfully misappropriated stock of Transcontinental (A102). Specifically, the following allegations relating to improper stock issuances and conversions were made (A176-177):

"22. From time to time, since on or about January 1, 1960 Fein had caused the stock of Trans to be issued at nominal, unfair and inadequate consideration to third parties whose names are not presently known to plaintiff, for the benefit of said defendant. Such issuance and sale of stock have been a waste of the assets of Trans...."

"23. From time to time, since on or about January 1st, 1960, Fein had caused to be purchased large quantities of the issued and outstanding stock of Trans under circumstances where the acquisition of said stock should have been for the benefit of Trans instead of for his own benefit...."

In addition to monetary damages, the complaint sought the following injunctive relief (A177-179):

"(d) Enjoining the defendants and each of them from transferring, assigning, alienating, mortgaging or pledging any and all shares of stock unlawfully obtained by them since January 1st, 1960 or from voting any of such stock;

"(e) Cancelling all shares of stock issued to the defendants or any of them or which, directly or indirectly, have unlawfully come into their ownership, possession or control since January 1, 1960.

....

"(g) Impressing a trust upon all shares of stock of Trans or other property or assets improperly acquired by the defendants or any of them which this Court may determine to have been wrongfully misappropriated or diverted from Transcontinental."

During the pendency of the derivative action, and in 1966, plaintiff Sackett and defendants Fein and Trenton negotiated a settlement (A102-105). A final judgment approving the settlement as fair and adequate was entered by Judge Tyler on July 26, 1966 (A208-210).

The settlement was based upon a stipulation, approved by Judge Tyler, consenting to a dismissal of the complaint:

> "with prejudice, against Trans, its successors and assigns and its stockholders, with respect to all claims or causes of action arising from, connected with or related to any of the matters or transactions alleged in the complaint... or which could have been asserted thereunder." (A166)

In addition, general releases, containing essentially the same language, were executed by Transcontinental and delivered to Fein and Trenton (A164-169).

In conjunction with the settlement, and expressly contingent thereon, an agreement, dated June 22, 1966, was entered into between Trenton and Sackett for himself and "as nominee" for undisclosed others ("the Agreement") (A362-378). The Agreement, which effectively transferred control of Transcontinental from Fein and Trenton to Sackett and his group, provided in pertinent parts as follows:

> (a) Trenton would transfer to Sackett (i) all of its right, title and interest in 650,000 shares of the common stock of Transcontinental which it owned of record and/or beneficially, (ii) the remaining $225,460.72 of a loan which Trenton had made to Transcontinental in 1960, (iii) the security therefor and (iv) Trenton's two-eighths interest in a property known as the Sedalia property;
>
> (b) Sackett agreed to pay Trenton $187,500; (A362-378).

On July 12, 1966, Judge Tyler approved the settlement of the derivative action (A208-210). Thereafter, the parties met on August 12, 1966 to close the Agreement (A105).

Upon obtaining the 650,000 shares of common stock of Transcontinental from Trenton, Sackett took over control of the company and became its new president. In that capacity, he proceeded to use the corporate machinery to renegotiate his agreement with the defendants and to attempt to extract from them their remaining shares in Transcontinental. Thus, in October 1966, he caused Transcontinental's counsel to direct the company's transfer agent to refuse to transfer any additional shares owned of record by Trenton and Fein on the grounds that the remaining shares owned by the defendants were "unregistered" (A382-383):

> "October 5, 1966
>
> Mr. Joseph Iacona, Vice President
> Continental Stock Transfer Corporation
> One Exchange Place
> Jersey City, New Jersey
>
> Re: Transcontinental Oil Corporation
>
> Dear Mr. Iacona:
>
> As counsel for Transcontinental Oil Corporation, and with and upon the express direction and approval of Mr. B. Edwin Sackett, president of the corporation, I instruct you to stop the further transfer on your records of any of the following certificates:
>
> ....
>
> At this time I can advise you that the corporate records which we have examined reveal that the afore-described stock is unregistered stock.
>
> ....

Very truly yours,

Irwin M. Taylor"

In addition to placing a stop order on all of Trenton's remaining shares, Sackett commenced this action on February 9, 1967 on his own behalf and on behalf of Transcontinental. The complaint for waste, mismanagement, misappropriation of stock, breach of contract and fraud sought damages and a turn over to the plaintiff of the shares then owned by the defendants and which were the subject of the stop-order. Once again Sackett alleged that Trenton and Fein had, since 1960, misappropriated and converted stock belonging to Transcontinental*. Alternatively, Sackett claimed that if defendants' stock had not been converted from Transcontinental then it should have been delivered to Sackett under the Agreement.

B. The D[illegible]ts Shares

At trial, the plaintiffs contended that in April 1960, 100,000 shares of stock were issued by Transcontinental to Arthur A. Desilets without consideration and that those shares at all times remained the property of Transcontinental. The District Court agreed and held that when defendants sought to transfer those shares in 1966 to Fieland they committed a conversion.

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* One count of the complaint alleged that the shares owned by the defendants were "unregistered", the pretext under which the stop-order was issued. However, on the eve of trial, plaintiffs abandoned that claim and sought instead to prove that the shares held by the defendants had been converted from the company.

In order to understand the facts relating to the issuance of the Desilets shares and how defendants came to rightfully acquire them, it is necessary to understand the history of Transcontinental in the late 1950's and early 1960's, when the Desilets shares were issued.

(i) Control of Transcontinental in the 1950's

In the 1950's Transcontinental was a public company controlled by persons unconnected with this litigation (Tr. 512-13*; A86). Defendant Fein first became a shareholder of Transcontinental in the early 1950's when he acquired in excess of 100,000 shares of common stock (Tr. 510-515; A8). Many of said shares, together with convertible debentures, were purchased by Fein from or through a New York stockbroker, Harry B. Leslie ("Leslie"), one of the additional defendants in this action (Tr. 510-515; A86).

In 1955 Leslie, who had acquired control of Transcontinental from one Lowell Birrell (Tr. 511), turned over control of the company to a group of people related to Virginia Iron, Coal & Coke Company ("Virginia Iron") and headed by one Samuel Brown (Tr. 512). The Virginia Iron group financed Transcontinental's drilling operations through the sale by Transcontinental of $550,000 of convertible debentures (Tr. 512-513). Fein and his sister purchased $70,000 of the debentures through Leslie (Tr. 512-513).

Several years later, and in or about 1957 or 1958, Leslie solicited Fein's assistance in a proxy fight which he

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* Page references preceded by the designation "Tr." are to the pages in the transcript of the trial on the issue of liability.

mounted to oust the Virginia Iron group from the management of Transcontinental (Tr. 513-514; A86). Leslie won the proxy fight and asked Fein to become president for a short period of time while he tried to place the company in the hands of someone familiar with the oil business (Tr. 514; A86). Fein agreed and thereafter discovered that the prior management had engaged in various wrongs against Transcontinental with respect to its oil drilling operations (Tr. 515-516; A87). In settlement of Transcontinental's claim against the Virginia Iron group, it was agreed that Transcontinental would be paid $550,000 by Virginia Iron to pay off the debentures which were coming due. In exchange, Virginia Iron received Transcontinental's oil properties in Texas (Tr. 516-517; A87). After the debenture holders were paid and the oil properties were turned over to Virginia Iron, Transcontinental's only remaining assets were a tax loss and some $55,000 in cash, which Fein turned into U.S. Treasury bonds (Tr. 517-518; A87).

(ii) Control of Transcontinental in Late 1959 and Early 1960: The Burkinshaw Regime

At the conclusion of the foregoing transactions, Fein advised Leslie that he wanted to resign his position with the company since it had become a time-consuming nuisance to him for which he had received no compensation, although he was supposed to get a salary of $10,000 per annum (Tr. 518). Leslie asked him to wait until he could find a company to take over Transcontinental (Tr. 517-518). Thereafter, Leslie brought Orville V. Burkinshaw

("Burkinshaw") and Thomas Cairns ("Cairns") to Fein with a proposal: Transcontinental would acquire White River Exploration Company, the owner of a Rangely, Colorado oil property, from Anglo-Pacific Oil and Gas, Ltd. ("Anglo-Pacific"), a Canadian company, in exchange for 1,000,000 shares of Transcontinental's common stock and other consideration. Anglo-Pacific was then controlled by Burkinshaw and Cairns (Tr. 519-521). The aforesaid transaction was effected by a written agreement dated as of October 1, 1959 and control of the company, through the delivery of 1,000,000 shares of Transcontinental stock, was thus transferred to Anglo-Pacific and Burkinshaw, its president. (Tr. 519-521).

Upon consummation of the transaction, Fein resigned as president of Transcontinental effective November 30, 1959 (Tr. 521-522; A88). Control of the company was turned over to Burkinshaw and his group and all of the books and records of the company were removed to offices in Canada (Tr. 520-521, 546; A88). Burkinshaw became president on November 30, 1959 and remained in that position until August 12, 1960 (A85; 95-97), at which time he was removed by the Board of Directors for various acts of fraud and mismanagement (Tr. 47-49).

(iii) Burkinshaw's Frauds Upon Transcontinental and Trenton and Fein

The removal of Burkinshaw resulted from acts of fraud perpetrated by him upon Transcontinental, Trenton and Fein in connection with, among other things, the acquisition

of oil and gas wells in Sedalia, Canada, ("the Sedalia property"). Burkinshaw had entered into arrangements for Transcontinental to acquire the Sedalia property and, at the last moment, was unable to obtain the requisite financing (Tr. 534-535). He asked Fein to attempt to raise the necessary funds (Tr. 535). Fein, together with Bernard Green, an attorney from Trenton, New Jersey, obtained the monies from Green and some of Green's clients and from a Dr. Weiss, all of whom, through the vehicle of defendant Trenton, raised $225,000 to lend to Transcontinental (Tr. 535-537). On April 11, 1960, Trenton loaned Transcontinental $242,500 (the additional $17,500 being personally furnished by Fein) and received as security Transcontinental's interest in the White River Colorado oil runs together with an assignment of the Sedalia property being acquired (Tr. 535-538). In addition, Trenton received 150,000 shares of Transcontinental stock from Transcontinental ("the Original Issue shares") together with a three-eighths working interest in the Sedalia property then being acquired (Tr. 537-538; A 89). Anglo-Pacific also participated in the transaction by acquiring one-third of Trenton's three-eighths working interest in the Sedalia property in exchange for 150,000 shares of the 1,000,000 shares which Anglo-Pacific had previously acquired in the Rangely deal ("the Anglo-Trenton shares") (A89).

After Trenton loaned the $242,500 to Transcontinental, it was discovered that part of the security for the

loan, twenty-five (25%) percent of the Colorado oil runs, had previously been assigned by Burkinshaw to someone else; that Burkinshaw had overstated the purchase price for the Sedalia property by some $65,000 and that he had taken the difference for his own benefit (Tr. 547, 646).

Upon learning of the frauds which had been perpetrated upon it by Burkinshaw and by Transcontinental, Bernard Green, on behalf of Trenton, demanded recission of the loan and a return of the $242,500 (Tr. 660, 665, 547-549).

In an effort to persuade Trenton to stay its hand and to compensate it for the frauds which had been committed by Burkinshaw, Fein (a) forced the resignation of Burkinshaw and his group from control of Transcontinental; resumed the presidency of the company; and placed Green and his partner Robinson on the Board, thereby putting the company back into American hands (Tr. 47-59; A95); (b) paid out of his personal funds those Trenton investors who insisted upon a return of their money (A97) and (c) delivered to Green a letter whereunder Transcontinental promised, among other things, to deliver to Trenton whatever shares it could recover from Burkinshaw, Anglo-Pacific, and those who acted with them, together with any treasury shares Transcontinental had. The letter given to Green, dated August 13, 1960, reads as follows (A95-97; A217):

TRANSCONTINENTAL OIL CORPORATION
P. O. Box 487, Rangeley, Colorado.

August 13, 1960.

Mr. Bernard L. Green
Trenton Products Company
Broad Street Bank Bldg.
Trenton, N.J.

Dear Mr. Green:

The following summarizes our understanding on the situation involving the default on the loan of $242,000 by us from Trenton Products.

1. Trenton Products has failed to receive the security provided for in the loan agreement. The prior management of this company fraudulently transferred such assets to others in violation thereof.

2. Trenton Products will support the management of this company in any litigation to secure the return of such assets. If successful therein, such assets will be transferred to Trenton Products to further secure its loan.

3. Pending the conclusion of this matter in a manner satisfactory to you, Trenton Products shall have no obligation whatsoever in relation to support of the Sedalia Gas property until the gas therein shall be connected to a gathering system and be sold. Thereafter, Trenton's share of such gas shall be charged with the operating costs applicable to its interest.

4. Trenton Products shall be entitled to receive from us, such additional shares of our company as we are able to recover from the former management and control of the company, together with such shares as may be held in the Treasury of the company, as partial recoupment of the damages sustained by you arising out of the failure of this company to perform its obligations, and without further obligation. While it is recognized that such shares have no value at this time due to the condition of the company, it is hoped that forbearance by you may result in this company being restored to viable condition in the immediate future.

5. We concede the insolvency of this company at this time. Nevertheless, it is our understanding that so long as we co-operate with you, that you will forego any effort to collect the $242,000 owed to you at this time with interest, and that you will co-operate in an effort to keep this company alive.

Very truly yours,

TRANSCONTINENTAL OIL CORPORATION

By
Bernard Fein, President"

In accordance with the above, and as will be discussed in detail below, all shares of common stock of Transcontinental in the company's possession or which it was able to recover from Burkinshaw, Anglo-Pacific and those acting with them were delivered to Trenton. Among the shares turned over to Trenton were the Desilets shares.

(iv) The Issuance of the Desilets Shares in 1960

The Desilets shares had been issued during the Burkinshaw regime, in Judge Conner's words "for reasons which remain unclear" (A91). At a Transcontinental board of directors meeting held on April 25, 1960, the board authorized the issuance of 100,000 shares of Transcontinental common stock to Arthur A. Desilets (These shares were represented by certificates numbered A 19557 through A 19576). Mr. Desilets is described in Judge Conner's opinion as a business associate of and a "mere front for Burkinshaw" (A92).

Although the reasons for the issuance of the Desilets shares were "unclear" to Judge Conner, he nevertheless concluded that they were issued without consideration even though the documentary evidence which was presented, 14 years after the event, spells out consideration for the transaction.

By letter dated January 20, 1960 (A225-226) and February 19, 1960 (A387) Marmot Holdings Ltd., a company owned by Desilets wrote to Transcontinental "c/o Buchman & Buchman" requesting the issuance of 1,200,000 shares of Transcontinental stock under the terms of an agreement purportedly entered into between Transcontinental, Marmot and one Virgil R. Chamberlain. There is no further evidence in the record relating to this alleged agreement made while Burkinshaw controlled the company out of Canada and no proof of the terms or conditions of the agreement was offered by plaintiffs. The record does reveal however, that Burkinshaw executed on behalf of Transcontinental a modification agreement, dated April, 1960, which reduced to 100,000 the number of shares to be delivered to Marmot (A228-229). No other signatures appear on the modification agreement, which provided in part, as follows:

> "WHEREAS, an agreement dated the 1st day of October, 1959, was entered into by and between Transcontinental, Marmot and Chamberlain; and
>
> WHEREAS, pursuant to the said agreement certain properties were to be delivered by Marmot to Transcontinental; and
>
> WHEREAS, Marmot is unable to give good title to said properties to Transcontinental; and

WHEREAS, the parties are interested in consummating the transaction with respect to the properties in British Columbia and in Montana; and

WHEREAS, the parties are desirous of securing general releases from each other.

NOW, THEREFORE, in consideration of the sum of One Dollar and other good and valuable considerations, it is hereby agreed as follows:

1. The consideration for the transfer of all of the properties set forth in Schedule "A" attached hereto shall be one hundred thousand (100,000) shares of Transcontinental.

2. Simultaneously with the execution of this agreement the parties hereto are executing general releases to each other. Copies of said general releases are attached hereto marked Exhibit "B" hereof."

Apparently, the modification agreement was executed on April 11, 1960 and thereafter the following resolution was passed at a meeting of the board of directors of Transcontinental held on April 12, 1960:

"Resolved, that the Board hereby authorizes and approves the modification agreement dated the 11th day of April, 1960 whereby there will be issued 150,000 shares of the authorized but as yet unissued shares of Transcontinental to Arthur A. Desilets, the nominee of Marmot Holdings Limited ...." **(A314)**.

Transcontinental stock certificates A 19557 through A 19576 were thereafter issued in the name of Arthur A. Desilets and were sent by Transcontinental's transfer agent to Transcontinental's then attorneys Buchman & Buchman on April 26, 1960 (A289).

In pre-trial discovery, plaintiffs addressed written interrogatories to Mr. Desilets in Canada, which

were answered on March 13, 1969 (Ex. LLLL).* Attached to those interrogatories were copies of 20 stock certificates of Transcontinental, A-19557 through A-19576, in the name of Arthur A. Desilets, each for 5,000 shares and aggregating 100,000 shares. The following is interrogatory 11 and the answer of Mr. Desilets.

Interrogatory

> "11. Have you at any time, to your best knowledge, assigned or transferred to any person any interest you or Marmot Holdings, Ltd. might have had in these twenty (20) stock certificates? If so, when did you do so, to whom and what paper or papers do you recall having signed?"

Answer

> "11. Yes, I remember signing several pieces of paper marked 'Power of Attorney' with respect to those Share Certificates in some lawyer's office but I do not remember where or to whom I signed over the Certificates."

Those stock certificates were in the possession of attorneys Buchman & Buchman who had received them on April 26, 1960 (A289). The record does not reveal whether or not Desilets signed the stock powers in the office of Buchman & Buchman, the then attorneys for Transcontinental, or some other attorney.

any event, all of the foregoing transactions occurred during the time that Burkinshaw controlled Transcontinental and between November 30, 1959 and August 12, 1960. After the ouster of Burkinshaw, defendants obtained the Desilets certificates, according to Buchman, in 1960. In accordance with the terms of the letter agreement of

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* References to trial exhibits not reproduced in the Appendix are designated "Ex. ".

August 13, 1960 the Desilets shares were given to Trenton together with other shares recouped by Fein and Green from Transcontinental, Burkinshaw, Anglo-Pacific, their agents, attorneys and "fronts" in order to forestall the calling of the Trenton loan and Transcontinental's certain bankruptcy.

At trial and in their post-trial brief, plaintiffs contended that "[a]lthough the minutes authorized the issuance to Arthur A. Desilets of 100,000 shares, there is nothing in the record to establish that any consideration was ever received by Trans for the issuance of such stock." (Plaintiffs' Post-Trial Main Brief, p. 31). From this they argue that "the Desilets shares remained at all times the property of Trans"; that they "should have been returned for cancellation"; and that defendants have not met their burden of establishing how or why they became or could have become at any time the owner of those shares." (Plaintiffs' Post-Trial Main Brief p. 34).

In response, defendants claimed their right to the Desilets shares based upon the letter of August 13, 1960 whereby Transcontinental agreed to turn over to Trenton all treasury shares and all shares which might be recovered "from the former management and control of the company." In addition, defendants urged that all claims relating to the issuance of shares to Desilets in 1960 and defendants' possession thereof from 1960 to 1966 were adjudicated in the 1965 derivative action and therefore are barred by res judicata, collateral estoppel, release and limitations.

(v) The Embezzlements of Burkinshaw and the Financial Insolvency of Transcontinental from 1960 to 1966

In addition to the fraud committed upon Trenton in connection with its loan to Transcontinental, Fein, who had sent an accountant to Calgary, Canada, to examine the books of the company, discovered that the $55,000 in U.S. Treasury notes, owned by Transcontinental, had been embezzled by Burkinshaw and Anglo-Pacific (Tr. 546; A97). As a result, Fein insisted that Anglo-Pacific issue a note for $39,043.50 to Transcontinental (A97; 223) secured by 550,000 shares of Transcontinental stock then owned by Anglo-Pacific (Tr. 556-558; A97). The note, dated as of December 31, 1959, was delivered in May 1960 (Tr. 557).

After Burkinshaw's removal from Transcontinental in August 1960, Transcontinental was unable to obtain payment on the $39,043.50 note which it had obtained from Anglo-Pacific. As a result, and after notice to Anglo-Pacific (A231-232), the collateral of 550,000 shares was sold on March 22, 1961 to Trenton for $10,000, which funds were desperately needed by Transcontinental for its operations (A98). Although Trenton was entitled to receive all of the shares pursuant to the letter agreement of August 13, 1960, it nevertheless paid Transcontinental the sum of $10,000 to aid the company in its efforts to survive.

The frauds of Burkinshaw resulted in long and protracted litigation between Transcontinental and Anglo-Pacific. The litigation finally terminated in 1965 with Transcontinental obtaining substantial, but uncollectable,

judgments (Tr. 576-578). The litigation, however, was the least of Transcontinental's problems.

Almost immediately after Burkinshaw's removal and in September, 1960, Transcontinental's income from its sole income producing properties in Rangely, Colorado was withheld as a result of litigation in Colorado (Tr. 567-568; A99-100). On October 13, 1961, an order was entered in the District Court of Colorado appointing a Receiver to collect the income, which receivership continued until December 14, 1964 (Tr. 568; A101).

Thus, from August 12, 1960, when Fein again became president of Transcontinental and up through August 1966, when he resigned his position, Transcontinental was insolvent (Tr. 640,644; A101).

It had no income from October 1960 to 1965 (Tr. 570, 641). It had no bank account, no employees and was unable to pay anyone, including defendant Fein, a salary (Tr. 641). Although it had public shareholders, it had no funds for auditors or attorneys and could send no notices to its shareholders (Tr. 644). Because of its dire position, it was unable to pay its stock transfer agent, Texas Bank & Trust Company, and said company refused to perform services for Transcontinental or to relinquish the company's records (Tr. 639-640). As a result, Fein and his secretary were required to take over the functions of transfer agent to the best of their respective abilities. Fortunately for Transcontinental, Fein was also the president of a company listed

on the New York Stock Exchange and thus had available to him the use of a secretary and office space (Tr. 503). Mr. Fein literally ran the affairs of Transcontinental out of his desk drawer at his office and from his home. Despite the necessarily sparse operations of the company, Mr. Fein and Trenton were required over the years, between 1960 and 1966, to lend in excess of $50,000 to Transcontinental to meet pressing obligations, including annual lease rentals on the Sedalia gas leases, which they determined were worth saving (Tr. 569-570; Tr. 1312-1313).

In the midst of Transcontinental's troubles, and in the early 1960's, plaintiff Sackett, a shareholder of Transcontinental and a customer of Harry B. Leslie, frequently communicated with Fein, inquiring about the status of the company (Tr. 21-23). Leslie was unable to communicate directly with Fein since they had a falling out in about 1961 when Leslie sought to end the dispute with Anglo-Pacific by reinstating Burkinshaw, which proposal Fein rejected (Tr. 597-599).

At no time between 1961 and 1965 did Sackett ever offer to assist Transcontinental in its financial difficulties (Tr. 1379). Instead, he waited until 1965, when both the Colorado receivership and the Anglo-Pacific litigation were concluding, and income started coming in on the Colorado property, to commence two stockholder actions against Transcontinental, its officers and directors, in an effort to take over control of the company (A101).

The claims of wrongful stock issuances and conversions in the early 1960's alleged by Sackett in those prior actions, and settled by a final judgment are the same claims which Transcontinental sought to relitigate in the First and Second Count of the complaint in this action.

I.

THE SECOND COUNT OF THE COMPLAINT SHOULD HAVE BEEN DISMISSED ON THE GROUNDS OF RES JUDICATA, COLLATERAL ESTOPPEL, RELEASE AND LIMITATIONS

Based upon the allegations of the complaint, the proof presented at trial and Judge Conner's own Findings of Fact, the Second Count of the complaint should have been dismissed on the grounds of res judicata, collateral estoppel, release and limitations.

A. The Prior Adjudication, Between the Same Parties on The Same Claims and Issues Bars the Second Count

(i) The Allegations of the Complaints Are The Same

Judge Conner correctly found that "the complaints in the 1965 action and the case at bar reveals that the second count in this action substantially duplicates paragraph 22 of the 1965 complaint" (A122).

In the Second Count of the Complaint in this action, plaintiffs alleged that on or about April 12, 1960, Fein caused Transcontinental to issue 100,000 shares of common stock to Arthur A. Desilets; that said stock was never delivered to Desilets; that Transcontinental never received any payment or remuneration for said 100,000 shares of stock; and that said stock was thereafter appropriated by Trenton and Fein and transferred by them to various persons on August 6, 1966. (A12-12A).

Paragraph 22 of the 1965 complaint alleged (A176):

> "22. From time to time, since on or about January 1, 1960 Fein had caused the stock of Trans to be issued at nominal, unfair and inadequate consideration to third parties whose names are not presently known to plaintiff, for the benefit of said defendant. Such issuance and sale of stock have been a waste of the assets of Trans...."

In the 1965 action, Sackett sought the following relief (A178):

> "(d) Enjoining the defendants and each of them from transferring, assigning, alienating, mortgaging or pledging any and all shares of stock unlawfully obtained by them since January 1st, 1960 or from voting any of such stock;
>
> ....
>
> (e) Cancelling all shares of stock issued to the defendants or any of them or which, directly or indirectly, have unlawfully come into their ownership, possession or control since January 1, 1960."
>
> ....
>
> "(g) Impressing a trust upon all shares of stock of Trans or other property or assets improperly acquired by the defendants or any of them which this Court may determine to have been wrongfully misappropriated or diverted from Transcontinental."

The 1965 action was settled and dismissed upon the entry of a final judgment on July 12, 1966 approving the settlement as fair and adequate. The stipulation of settlement, specifically approved by Judge Tyler, consented to a dismissal of the complaint (A166):

> "with prejudice, against Trans, its successors and assigns and its stockholders, with respect to all claims or causes of action arising from, connected with or related to any of the matters or transactions alleged in the complaint * * * or which could have been asserted thereunder."

In addition, general releases, containing essentially the same language, were executed by Transcontinental and delivered to Fein and Trenton (A202,204).

On the basis of all of the foregoing, Judge Conner correctly concluded that the instant complaint duplicated the

prior complaint. However, the District Judge found that the proof at trial presented a claim (the transfer to Fieland in August 1966) which had not been previously adjudicated and was therefore not barred. As will be shown below, the Court's determination ignores the identity of the issues litigated and is therefore contrary to the law of res judicata and collateral estoppel and is clearly erroneous.

(ii) The Issues and Claims Presented at Trial Are Barred by the Prior Adjudication

Accepting arguendo the District Court's Findings of Fact, the issues and claims litigated at trial are barred by the prior adjudication.

In Judge Conner's own findings, he concluded that:

(a) Transcontinental issued 100,000 shares of stock to Arthur A. Desilets pursuant to a resolution of the board of directors passed at a meeting on April 12, 1960; (A91).

(b) "The shares were issued...without any consideration for their issuance" (A122-123)*;

(c) The certificates for the 100,000 shares were transmitted by the transfer agent to attorneys Buchman & Buchman, who notified Fein of their receipt on April 26, 1960 and delivered them to Fein shortly thereafter (A93);

(d) Fein held those certificates in his possession until August 1966 (A94).

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* This conclusion of the Court is not included in its Finding of Facts but in the body of its opinion. As will be urged below, the record is devoid of any evidence supporting this conclusion.

The 1965 complaint similarly accused the defendants of causing the issuance of Transcontinental stock "at nominal, unfair and inadequate consideration to third parties." Plaintiffs in this action again urged that "there is nothing in the record to establish that any consideration was ever received by Trans for the issuance of such stock." (Plaintiffs' Post-Trial Main Brief, p. 31). Judge Conner agreed and found that the Desilets "shares were issued, pursuant to an April 12, 1960 resolution of the board of directors, without any consideration for their issuance" and were therefore "void" (A122-123).

These are the very same issues raised in the prior action and should be barred.

All claims relating to the validity of the issuance of the Desilets shares in 1960 and defendants' right of possession, from 1960 to July 12, 1966, are barred by the prior judgment. These are obvious conclusions which Judge Conner chose to ignore.

In the complaint in the prior action Sackett attacked defendants' right to "any and all shares of stock unlawfully obtained by them since January 1st, 1960" (A178); sought to cancel all shares of stock "which, directly or indirectly, have unlawfully come into their ownership, possession or control since January 1, 1960" (A178); sought to impress a trust "upon all shares of stock of Trans...acquired by the defendants" and "wrongfully misappropriated or diverted from Trans" (A178) and sought to enjoin the defendants "from

transferring, conveying, pledging, encumbering, mortgaging or commingling the assets of Trans" (A177).

When the final judgment was entered in the prior action on July 10, 1966, defendants had in their "possession or control" large amounts of shares of Transcontinental, including the Desilets shares. The settlement of the prior action on that date barred any further attack upon defendants' rights to the shares in their "possession or control" and fully adjudicated all facts relating to the issuance of the Desilets shares in 1960 and defendants' right to possession and control of those shares in 1966.

When defendants transferred the Desilets shares to Fieland in August 1966, the issue of whether those shares had been validly issued and were rightfully in the possession of defendants had been adjudicated. Only by reopening those issues, which were already barred, could the District Court reach its conclusion that the August, 1966 transfer to Fieland was a conversion. That determination was clearly erroneous and a misapplication of the rules of collateral estoppel and res judicata.

In a similar situation in Ruskay v. Jensen, 342 F. Supp. 264 (S.D.N.Y. 1972), Judge Metzner granted summary judgment for defendants on the ground that the action was barred by a judgment entered in settlement of an earlier derivative suit.

Judge Metzner stated the rules of res judicata and collateral estoppel as follows (342 F. Supp. at 268):

"... the judgment in a prior suit, if rendered on the merits, is res judicata in a subsequent action between the same parties on the same claim or cause of action and operates as an absolute bar not only as to every ground of recovery or defense actually presented in the prior action, but also as to every ground which might have been presented. However, where the second action is upon a different claim or demand, the prior judgment operates as an estoppel only as to those issues actually litigated and determined in the prior suit. See also Lawlor v. National Screen Service Corp., 349 U.S. 322, 326, 75 S.Ct. 865, 99 L.Ed. 1122 (1955); Commissioner of Internal Revenue v. Sunnen, 333 U.S. 591, 597, 68 S.Ct. 715, 92 L.Ed. 898 (1948); Baltimore Steamship Co. v. Phillips, 274 U.S. 316, 319, 47 S.Ct. 600, 71 L.Ed. 1069 (1927)."

The Court noted that the application of the foregoing rules requires the answering of five basic questions (342 F. Supp. at 268):

"(1) Were the parties in the prior action the same as in the present one?

(2) Did the prior action go to judgment?

(3) If so, was that judgment on the merits?

(4) Were the claims or causes of action in the prior suit the same as in the present One?

(5) If not, what issues were actually litigated and determined in the prior suit?"

The first three questions are easily answered. The parties in the prior action are the same as in the present action. Transcontinental, the real party in interest in the prior action, has asserted claims against Trenton and Fein in both actions. A judgment was entered in the prior action approving a settlement and dismissing the complaint. Such a judgment is on the merits and is given full res judicata effect in a subsequent suit between the same parties on the same causes of action as those compromised in the settlement. Ruskay v. Jensen, supra., at 269. Smith

v. Alleghany Corp., 394 F. 2d 381, 391 (2d Cir.), cert. denied, 393 U.S. 939, (1968); Stella v. Kaiser, 218 F.2d 64, 65 (2d Cir. 1954), cert. denied, 350 U.S. 835, (1955).

The analysis of the claims and issues in both the present and prior suits, as discussed above, demonstrates their identity. In both actions plaintiffs claimed that Transcontinental had issued 100,000 shares of stock to Desilets in 1960 without consideration. In both actions, plaintiffs claimed that since 1960 the defendants were wrongfully in possession of the Desilets shares. Notwithstanding this identity of issues and claims, the District Court incorrectly refused to dismiss the Second Count as barred by res judicata and collateral estoppel.

B. The Statute of Limitations Bars the Second Count

The claims asserted by plaintiffs in the Second Count, relating to the 1960 stock issuance to Desilets, without consideration, and the alleged wrongful possession of said stock by the defendants from 1960 to 1966 is time barred by the applicable three year statute of limitations for conversion C.P.L.R. § 214; Civil Practice Act § 49(7); Klein v. Bower, 421 F. 2d 338 (2d Cir. 1970).

The wrongful issuance, possession and conversion of the Desilets shares was claimed in the complaint to have first occurred in 1960 (A12). Those claims were all barred by 1963 and certainly by February 9, 1967 when this action was commenced.

In an attempt to avoid the defense of limitations, plaintiffs cannot rely upon C.P.L.R. § 213 (8) and (9), a six

year statute of limitations for actions against officers, directors and shareholders. C.P.L.R. § 213 (8) provides a six year statute of limitations in an action by a corporation against a former director, officer or stockholder for, among other things, waste or injury to property or for an accounting in connection therewith. Under the Civil Practice Act § 48, subd. 8 and § 49, subd. 7, such actions had only a three year period of limitations. Said act was in effect at the times of the alleged wrongs in 1960 and 1961 and was replaced by the C.P.L.R. on September 1, 1963. C.P.L.R. § 218(a) provides that all causes of action barred at September 1, 1963 are not affected by the new Act. Thus, all of plaintiffs' claims which were over three years old at September 1, 1963 (i.e. predate September 1, 1960) are barred under any theory which plaintiffs espouse. As to those causes of action which were not barred at September 1, 1963, even under the C.P.L.R. six year statute, all claims accruing prior to February 9, 1961 would be barred since this action began February 9, 1967.

In summary, therefore, plaintiffs claims are barred by the three year statute of limitations for conversion. At the very least, even if the six year statute controls, all acts or wrongs occurring prior to February 8, 1961 are barred. Since the Second Count of the complaint attacks the wrongful issuance of shares, without consideration, in 1960 and the wrongful possession of those shares by the defendants since 1960, it is time barred.

The plaintiffs, and Judge Conner in his opinion, attempt to avoid the defense of limitations, together with the defenses of res judicata and collateral estoppel, by urging that the conversion sued upon did not occur until August 1966, when the Desilets certificates were delivered to Fieland. Thus, in its opinion, the District Court finds that the Desilets shares were issued in 1960 without consideration and were therefore "void"; that defendants held those shares in their possession together with hundreds of thousands of other shares, from 1960 to 1966; that in 1966 defendants took all of the shares in their possession and sold 650,000 shares to Sackett; and that of the balance of the shares in their possession, defendants delivered 100,000 shares to Fieland, which happened to be the Desilets shares, and that the defendants thereby committed a conversion of those shares.

In following the above rationale, the District Court totally ignores the fact that the claims and issues relating to the 1960 stock issuance, allegedly without consideration, and the defendants' right to possession of the stock since 1960, are all conceded to be, by the Court's own opinion, barred by the prior adjudication and limitations. Thus, the 1966 delivery to Fieland cannot be found to have been wrongful since all of the elements necessary to find that the shares were the property of Transcontinental since 1960 are barred.

(i) The 1970 Amendment Does Not Relate Back

Finally, the District Court has acknowledged that the issues and claims as originally alleged in the Second Count of the complaint are barred. However, it finds that the plaintiffs' claim was changed in pre-trial in October 1970 to allege a 1966 conversion (i.e., the transfer to Fieland); and that therefore the claim is not barred by the prior adjudication or by limitations. However, by October, 1970 an attack upon the 1966 transfer to Fieland would have been barred if for no other reason than that it was first alleged more than three years after the date of the conversion in August 1966. Moreover, under Judge Conner's rationale, the 1970 amendment could not relate back to the 1967 filing of the complaint since it is a new claim for relief based on different facts (i.e., the 1966 transfer to Fieland). New claims for relief based upon different facts do not relate back. See 3 Moore, Federal Practice (2d Ed. 1974) ¶ 15,15[3], at 1026 and cases cited in footnote 5. Indeed, if it were not a new claim based on different facts (as defendants' contend) it should have been dismissed by Judge Conner as res judicata and barred by limitations. Accordingly, this allegedly new claim should have been dismissed as barred by limitations.

C. The Previously Adjudicated and Time Barred Claims And Issues Should Finally Be Dismissed

In summary, this Court should reverse the judgment entered on the Second Count on the grounds of res judicata, collateral estoppel, release and limitations. Over eleven

years ago, in 1965, Sackett brought his derivative action. In that action he attacked wrongful stock issuances for "nominal, unfair and inadequate consideration" going back to 1960 and questioned defendants' right to their "possession or control" of Transcontinental stock. That action was finally adjudicated in July 1966. Nonetheless, after taking over control of Transcontinental, Sackett, in 1967, again brought suit attacking the same stock issuances and transactions. Even worse, when this action was tried in 1974, plaintiffs attempted to prove further claims, going back to 1960, and far beyond the scope of the claims alleged in their complaint. Thus, for example, the First Count of the complaint accused defendants of misappropriating 300,000 shares of Transcontinental stock. At trial, defendants were required to defend against claims of misappropriating, in 1960, 900,000 shares of Transcontinental stock. On the Second Count, defendants were required to defend against claims relating to the consideration for issuance in 1960 of the Desilets shares. Thus, defendants were called upon to account for transactions which occurred 14 years earlier, on claims far beyond the scope of the complaint and with respect to a company which was insolvent and moribund from 1960 to 1966. Memories fade, documents cannot be located and witnesses die.* The very purpose of the defenses of res judicata, collateral estoppel, release and limitations is

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* Bernard Green of Trenton, who would have been one of defendants key witnesses, died in the mid 1960's (Tr. 603).

precisely to avoid what has happened in this case. The District Court's refusal to uphold those defenses and to permit proof of claims far beyond the scope of the pleadings was improper and placed upon the defendants an unfair and almost impossible burden, denying to them due process of law and reasonable opportunity to defend the action.

It is for all of these reasons that the finality of the 1966 judgment should be upheld and the statute of limitations periods strictly applied. The stale claims which plaintiffs sought to pursue in this action should, once and for all, be dismissed.

II.

DEFENDANTS RIGHTFULLY ACQUIRED THE DESILETS SHARES AND DID NOT CONVERT THEM. JUDGMENT ON THE SECOND COUNT SHOULD THEREFORE BE REVERSED.

The undisputed testimony at trial established that Trenton rightfully acquired the Desilets shares in 1960 after it had been discovered that Burkinshaw and Transcontinental had defrauded Trenton in connection with Trenton's loan of $242,500 to Transcontinental.

The following facts were not disputed and were adopted by Judge Conner in his Findings of Fact:

Burkinshaw controlled Transcontinental from November 30, 1959 to August 12, 1960 when he was removed by the board of directors for various acts of fraud and mismanagement (A88, 94-95)

During his tenure and on April 11, 1960 he caused Transcontinental to borrow $242,500 from defendant Trenton to acquire the Sedalia property. Trenton received various security for the loan (Tr. 535-538) together with 150,000 shares of Transcontinental stock from Anglo-Pacific and 150,000 shares from Transcontinental together with a one-quarter undivided interest in the Sedalia property then being acquired (Tr. 535-538; A88-89).

After Trenton loaned the $242,500 to Transcontinental, it was discovered that part of the security for the loan, twenty-five (25%) percent of the Colorado oil runs, had previously been assigned by Burkinshaw to someone else; that Burkinshaw had overstated the purchase price for the Sedalia property by some $65,000 and that he had taken the difference for his own benefit (Tr. 547, 646; A94-95).

Upon learning of the frauds which had been perpetrated upon it by Burkinshaw and by Transcontinental, Bernard Green, on behalf of Trenton, demanded recission of the loan and a return of the $242,500 (Tr. 660, 665, 547-549; A95).

In an effort to persuade Trenton to stay its hand and to compensate it for the frauds which had been committed by Burkinshaw, Fein, on August 12, 1960, forced the resignation of Burkinshaw and his group from control of Transcontinental , resumed the presidency and placed Green and his partner Robinson on the Board, thereby putting the company back into American hands (Tr. 47-59). In addition, Transcontinental delivered to Trenton a letter (A-95-97) whereunder Transcontinental acknowledged its default on the loan and its inability to repay the loan and agreed, among other things:

> "4. Trenton Products shall be entitled to receive from us, such additional shares of our company as we are able to recover from the former management and control of the company, together with such shares as may be held in the Treasury of the company, as partial recoupment of the damages sustained by you arising out of the failure of this company to perform its obligations, and without further obligation. While it is recognized that such shares have no value at this time due to the condition of the company, it is hoped that forbearance by you may result in this company being restored to viable condition in the immediate future.
>
> 5. We concede the insolvency of this company at this time. Nevertheless, it is our understanding that so long as we cooperate with you, that you will forego any effort to collect the $242,000 owed to you at this time with interest, and that you will co-operate in an effort to keep this company alive."

The Trenton loan was thus hopelessly in default with no prospects for repayment. The letter of August 13, 1960 and the

agreement to deliver additional stock to Trenton was all that Fein could promise to avoid certain bankruptcy if the loan were called.

In accordance with the letter of August 13, 1960, Fein subsequently recovered for Trenton all of the shares of common stock in Transcontinental's treasury and all shares which Fein was able to recover from "the former management and control of the company" including Anglo-Pacific, Burkinshaw, Desilets and their attorneys, Buchman & Buchman.

Among the shares which Fein was able to recover were the 100,000 shares registered in the name of Arthur A. Desilets, an individual who Judge Conner referred to as "a mere front for Burkinshaw".

Since 1960 and throughout this litigation, Trenton has claimed ownership of the Desilets shares by virtue of the letter agreement of August 13, 1960.

Judge Conner, while not disputing any of the above facts, found that the letter agreement of August 13, 1960 did not apply to the Desilets shares (A123):

> "That agreement only applies to treasury stock and to shares recovered from Anglo. The Desilets shares do not fit either category. Having never been in Anglo's possession or ownership, they could not possibly have been recovered from Anglo, and having been illegally issued without consideration they could never attain the status of treasury shares."

First, the Desilets shares were recovered "from the former management and control" of Transcontinental. Whether they were recovered directly from Burkinshaw, the president of Anglo-Pacific and the former president of Transcontinental, or indirectly from Desilets, one of Burkinshaw's "fronts" is irrelevant.

The shares were, in fact, recovered from Burkinshaw, "the former management", or one of his "fronts".

Secondly, Judge Conner is wrong in concluding that the Desilets shares were not treasury shares.* Throughout this litigation, plaintiffs have conceded that the Desilets shares were treasury shares. In paragraph (f) of the pre-trial order dated October 15, 1970 plaintiffs stated that "Fein and Trenton misappropriated and converted 100,000 shares of Trans treasury stock, then standing in the name of one Arthur A. Desilets."

Thus, plaintiffs conceded and defendants did not dispute at trial that the Desilets certificates were treasury shares. Accordingly, under the August 13, 1960 letter agreement, Trenton became entitled to those shares.

In addition, there is no basis in the record for the District Court, on its own initiative, to have concluded that the Desilets shares were not treasury shares. Those shares were issued pursuant to resolution of the board of directors passed on April 12, 1960, apparently in settlement and modification of an aborted transaction which would have required the issuance of 1,200,000 shares. Judge Conner's conclusion that the 100,000 shares were issued "without consideration" and therefore "could never attain the status of treasury shares" is totally unsupported by the record and was not proven by plaintiff. Indeed, Judge Conner conceded that plaintiffs failed to carry their burden of proof when he stated in his opinion that the Desilets shares were issued "for reasons which remain unclear" (A91).

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* It should be noted at this point that Judge Conner, in his decision on damages, referred to the Desilets shares as "treasury shares" (A155).

If anything, the evidence presented at trial gives rise to the inference that the Desilets shares were in fact issued for valid consideration. The documentary record reveals that prior to the resolution authorizing the issuance of the Desilets stock, two letters dated January 20, 1960 (A225-226) and February 19, 1960 (A387) respectively from Marmot Holdings Ltd., a company owned by Desilets, requested the issuance of 1,200,000 shares of Transcontinental stock under the terms of an agreement purportedly entered into between Transcontinental, Marmot and one Virgil R. Chamberlain.

The letter dated January 20, 1960, from Marmot to Transcontinental "c/o Buchman & Buchman" stated (A225-226):

> "Under the terms of the agreement between Transcontinental Oil Corporation, Marmot Holdings Ltd., and Virgil R. Chamberlain, dated October 1, 1959, Transcontinental Oil Corporation agreed to issue 1,200,000 shares of its common stock to this company in consideration for certain petroleum and natural gas properties.
>
> Would you kindly issue these certificates in the names of the nominees, and in the denominations as set out on the attached schedule.
>
> Please have the transfer agent forward the certificates to Buchman & Buchman, 292 Madison Avenue, New York 17, New York, and we will arrange to have one of our men pick them up in person."

There was also placed in evidence a copy of an agreement amongst Transcontinental, Marmot and Chamberlain dated April 1960, signed only by Burkinshaw on behalf of Transcontinental (A228-229). In relevant part the agreement provided:

> "WHEREAS, an agreement dated the 1st day of October, 1959, was entered into by and between Transcontinental, Marmot and Chamberlain; and
>
> WHEREAS, pursuant to the said agreement certain properties were to be delivered by Marmot to Transcontinental; and

WHEREAS, Marmot is unable to give good title to said properties to Transcontinental; and

WHEREAS, the parties are interested in consummating the transaction with respect to the properties in British Columbia and in Montana; and

WHEREAS, the parties are desirous of securing general releases from each other.

NOW, THEREFORE, in consideration of the sum of One Dollar and other goods and valuable considerations, it is hereby agreed as follows:

1. The consideration for the transfer of all of the properties set forth in Schedule "A" attached hereto shall be one hundred thousand (100,000) shares of Transcontinental.

2. Simultaneously with the execution of this agreement the parties hereto are executing general releases to each other. Copies of said general releases are attached hereto marked Exhibit "B" hereof."

Apparently, some time after the modification agreement, the resolution of the board of directors was passed on April 12, 1960 authorizing the issuance of 100,000 shares to Mr. Desilets.

Transcontinental stock certificates A 19557 through A 19576, were thereafter issued in the name of Arthur A. Desilets. Those certificates were sent by Transcontinental's transfer agent to attorneys Buchman & Buchman on April 26, 1960 (A 93).

In response to plaintiffs' written interrogatories, served in pre-trial, Mr. Desilets stated that he recalled signing stock powers for those stock certificates in an attorney's office (Ex. LLLL).

After the removal of Burkinshaw from office, Buchman & Buchman turned the Desilets certificates over to the defendants (Tr. 1474).*

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* Abraham Buchman testified the certificates were delivered by him to the defendants (Tr. 1474). Defendant Fein testified that those certificates were delivered by Burkinshaw to Trenton (Tr. 1248).

Trenton thus received the Desilets shares in 1960, after Burkinshaw's frauds were uncovered, and pursuant to the letter agreement of August 13, 1960.

Defendants submit that plaintiffs' claim and Judge Conner's holding that the Desilets shares were issued "without any consideration" must fail on two counts. First, plaintiffs failed to carry their burden of proving that the shares were issued without any consideration. (As Judge Conner noted, the reasons for their issuance "remain unclear"). Secondly, what proof was presented established, at least presumptively, that there was a bona fide transaction between Transcontinental and others which was modified and compromised by the issuance of the 100,000 shares of stock and an exchange of releases.

Consideration to Transcontinental for the shares is spelled out in the modification agreement and includes its receipt of a release of its obligation to deliver 1,200,000 shares of its stock to Marmot.

Accordingly, Judge Conner's conclusion that there was no consideration for the transaction is totally unsupported by the record and is clearly erroneous.

In summary, defendants received the Desilets shares after the ouster of Burkinshaw in 1960. Under the letter agreement of August 13, 1960, Trenton is entitled to those shares since they were recovered "from the former management and control of the company" or were treasury shares of the company. The District Court's holding to the contrary is, we submit, clearly erroneous and should be reversed.

III.

PLAINTIFFS FAILED TO PROVE DAMAGES ON THE SECOND CAUSE OF ACTION AND THE MEASURE OF DAMAGES FIXED BY THE DISTRICT COURT IS CLEARLY ERRONEOUS

A. The Damages Awarded By The District Court Are Unsupported By The Record

In its decision of July 31, 1975, the District Court held that plaintiff Transcontinental was entitled to recover for the "damages proximately resulting" from the conversion in 1966 of the Desilets shares and directed a hearing on the issue of damages. That hearing was held on December 8, 1975.

At that hearing, plaintiffs presented no proof of actual market transactions to prove the value of the 100,000 shares of Transcontinental stock which allegedly was converted.

Indeed, as to plaintiffs' proof, Judge Conner noted that "[p]laintiffs' counsel unfortunately has put in very little proof as to the market value of Trans stock during the applicable period. For example, no expert testimony was introduced by plaintiff" (A152). Judge Conner went on to note that although proof of certain sales of Transcontinental stock could have been made and "may have been the very best evidence of the market value of the Desilets shares, plaintiffs' counsel, Mr. Taylor, inexplicably failed to adduce any evidence, either testimentary or documentary, tending to prove the existence of these transactions" (A152).

The value of a large block of stock can be established through proof of bona fide sales, taking into account the size of the block of stock and the fact that the shares were not registered* and could only be sold on an investment basis. (Kupferman v. Consolidated & Research Mfg. Corp., CCH Fed. Sec. L. Rep. [1961-64 transfer binder] ¶ 91,197, at 93,951 (S.D.N.Y. 1962); Siegler v. Living Aluminum, Inc., CCH Fed. Sec. L. Rep. [1961-64 transfer binder] ¶91,266, at 94,211 (Sup. Ct. N.Y.Co. 1963).

Transcontinental made no attempt to prove actual trades, even though, as Judge Conner noted, proof of such trades was available. In Kupferman v. Consolidated Research Mfg. Corp., supra, Judge Levet, in attempting to value stock, considered proof of actual purchases and sales which were offered into evidence by plaintiff. Similarly, in Siegler v. Living Aluminum, Inc., supra, the Court considered "a bona fide sale" to establish the value of stock.

In order to attempt to establish value Transcontinental offered a report of National Quotation Bureau (A428-438). At trial, defendants did not object to the authenticity of the report upon the express stipulation with plaintiffs' counsel that the National Quotation Bureau report did not reflect actual transactions and reflected only alleged bids and offers for 100 shares. (12/8/75 Tr. 5-9**). Defendants urged that only proof of actual trades could establish value and objected to the acceptance of the report in evidence (12/8/75 Tr. 5-9).

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* It will be recalled that in October 1966 Transcontinental's counsel placed a stop-order on the shares and advised the transfer agent that the shares were "unregistered" (A382-383).

** References to "12/8/75 Tr." are to pages in the transcript of the trial on damages held on December 8, 1975.

Thus, the introduction into evidence of the report of quotations was not the best evidence available and it in no way tended to establish a value for 100,000 shares of Transcontinental stock, let alone unregistered shares. Since this report was the sole basis for Judge Conner's conclusion that the shares were worth $.44 per share, his ruling should be reversed.

Plaintiffs offered no expert testimony as to the then value of Transcontinental stock, either registered or unregistered, or as to the weight or significance to be given to the National Quotation Bureau quotations in arriving at a value for the stock. On the contrary, only defendants presented expert testimony on the subject of valuation and the weight, if any, to be given to the alleged quotations.

The uncontradicted testimony of investment advisor and defendants' stock market expert Robert Martin, when considered together with actual transactions in Transcontinental stock in 1966, as proven by defendants, demonstrates beyond dispute that the Desilets shares had little or no value in 1966.

In reaching his conclusion that the shares were virtually worthless in 1966, Mr. Martin took the following into consideration (12/8/75 Tr. 24-30, 36-41):

(a) The sordid financial history of the company as set forth in the District Court's lengthy opinion and conclusion that Transcontinental "has been the victim over the years of sufficient fraud to scare off a generation of investors" (A83-84);

(b) The large size of the block of stock which would necessarily require a substantial discount from the market price to be paid for a few hundred shares;

(c) The unregistered nature of the stock which would require a large discount from market;

(d) The lack of public information which was available on the company;

(e) The fact that Transcontinental was an over-the-counter penny stock;

(f) The fact that the cost of a registration statement to register the shares would cost over $20,000, an amount in excess of the value of the shares.

Mr. Martin concluded that all of these factors made it unlikely that in 1966 any investor would be willing to purchase 100,000 shares of Transcontinental at any price (12/8/75 Tr. 25-28).

Furthermore, Mr. Martin noted that if an attempt was made to fix a value for the 100,000 shares (aside from whether anyone would be willing to pay that value), one would have to consider only actual transactions in the Transcontinental common stock in 1966. Mr. Martin rejected the use of the National Quotation Bureau quotations relied upon by the plaintiffs for the reason that they did not reflect actual trades, at best they were reported bids and offers for 100 shares and, at worst, they were merely statements of brokers testing the waters to ascertain whether there was any public interest in either buying or selling the Transcontinental stock (12/8/75 Tr. 27). Because of these infirmities, Mr. Martin turned to two actual transactions in the common stock which occured in 1966 (12/8/75 Tr. 28):

(a) Mr. Martin reviewed the agreement entered into by Sackett and the defendants in June 1966 and which closed in August 1966. The witness concluded that Sackett and his group paid $187,500 for a Transcontinental indebtedness of $225,460.72

and paid nothing for the 650,000 shares of common stock of Transcontinental. A reading of the agreement, as supported by the testimony of the parties, demonstrates that no value was attributed to the shares, thereby confirming Mr. Martin's conclusion that the shares of Transcontinental in 1966 were virtually worthless.

(b) In October 1966, Sackett and his group caused Transcontinental to issue to themselves debentures convertible into common stock at $.25 per share, which shares would be registered upon appropriate demand (A282-286). Mr. Martin noted that conversion prices were traditionally fixed above the market; and that the Transcontinental shares could not possibly be valued in the market at in excess of $.25 per share for if they were, the insiders would be bestowing upon themselves an illegal benefit which should not be presumed. Mr. Martin testified that conversion prices are normally fixed at a price of at least 25% above market. In this case, the company and its insiders would therefore be valuing Transcontinental stock, in October, 1966, at a price of from $.10 to $.15 per share. It must be noted, however, that these unregistered shares carried with them, under the debenture, an obligation by Transcontinental to file a registration statement. Any other unregistered shares (such as the Desilets shares) which did not carry with them an obligation of Transcontinental to furnish a registration statement, would probably be worthless and would have a value of far less than $.10 to $.15 per share. Indeed, a registration statement, required to sell the Desilets shares to the public, would cost over

$20,000, far more than the value of the 100,000 shares, thereby rendering the shares virtually worthless (12/8/75 Tr. 40).

The June 1966 and October 1966 transactions in Transcontinental stock, referred to in (a) and (b) above, when considered together with the sordid history of the company and its insolvent condition in 1966, led Mr. Martin to reasonably conclude that 100,000 shares of unregistered Transcontinental shares were virtually worthless and of minimal value in October 1966 (12/8/75 Tr. 27-28).

His conclusions and the facts upon which they were based were not rebutted by plaintiffs or seriously questioned upon cross-examination. Moreover, his conclusions are supported by existing case law on valuation of securities.

Mr. Martin considered only bona fide transactions which took place in 1966. Kupferman v. Consolidated Research & Mfg. Corp., CCH Fed. Sec. L. Rep. [1961-64 transfer binder] ¶91,197, at 93,951 (S.D.N.Y. 1962) Siegler v. Living Aluminum Inc., CCH Fed. Sec. L. Rep. [1961-64 transfer binder] ¶91,266, at 94,211 (Sup. Ct. N.Y.Co. 1963).

Consistant with Mr. Martin's conclusion that unregistered stock should be valued at a substantial discount from market, Judge Levet, in the Kupferman case, found a 50% discount to be warranted. Uniformly, unregistered shares have been valued at substantial discounts from market. See, e.g., SEC Accounting Series Release No. 113, CCH Fed. Sec. L. Rep. ¶72,135 (Oct. 12, 1969); Specialty Paper & Board Co., Inc., 24 CCH T.C. Mem. 1085 (1965) Husted, 47 T.C. 664 (1967); Hirsch, 51 T.C. 121,135 (1968).

Another factor to be considered in discounting the value of stock is the size of the block involved. In the Siegler case the Court recognized that the sale of a large block of stock "would have reduced the selling price of these shares substantially" (Siegler v. Living Aluminum Inc., supra, at 94,209). Again in Husted, the Tax Court also recognized the propriety of attributing a discount to a large block of stock (Husted, supra, at 678).

In summary, the sordid financial history of Transcontinental, the large block of unregistered over-the-counter penny stock involved, the lack of public information available on the company, the large expense involved in registering the shares and the only two bona fide 1966 transactions, when all are considered together, compel the conclusion that the Desilets shares were worthless or of little value in 1966.

The District Court's finding to the contrary is totally unsupported by the record and is clearly erroneous. The conclusion that an alleged quotation of an "asked" price of 44¢ per share established that a purchaser would be willing in 1966 to pay $44,500 for 100,000 shares of Transcontinental stock, let alone unregistered stock, is absurd when one considers all of the relevant facts. In Judge Conner's opinion, he ignores the fact that the Desilets shares were unregistered and all of the factors required to be considered in valuing Transcontinental securities. If any or all of the relevant factors were considered, the Desilets shares would have been found virtually worthless. More-

over, Judge Conner totally ignored the only actual transaction in the securities of Transcontinental in October 1966 put in evidence. That transaction was not the questionable quotation of a "bid" of $.44 for 100 shares but rather the issuance by Transcontinental in October 1966 of debentures convertible into common stock at $.25 per share, a price, according to the expert testimony, usually fixed at least 25% above market. Thus, Transcontinental's own insiders were, in October, 1966, placing a value on Transcontinental's shares at between $.10 and $.15 per share. Accordingly, Judge Conner's valuation of the shares at $.44 per share was clearly erroneous and should be reversed.

B. The Award of $35,000 Was Made by the Court Upon a Claim Never Asserted by Plaintiffs and Against Which Claim Defendants Had No Opportunity to Defend

The District Court found plaintiffs' damages to be $.44 per share on 30,000 shares of stock. In addition, it found plaintiffs entitled to recover damages of $35,000 on 70,000 shares of stock by reason of the fact that defendants allegedly gave Fieland the 70,000 shares to eliminate a $35,000 obligation. This claim was never relied upon by plaintiffs at trial, and defendants were never given the opportunity to defend against it. In addition, it is unsupported by the record and should be reversed.

In his opinion on damages, Judge Conner stated that "Fein used the converted stock (the stock transferred to Fieland was derived from the Desilets shares) to buy off a $35,000 claim against which he had no apparent defense" (A156). That claim was

not made, alleged or proven by plaintiffs at the trial on the issue of damages. Rather the claim was first conceived and stated by Judge Conner in his opinion after trial.

The only contention made by plaintiffs at the trial on damages was that "Fieland was accepting the 70,000 shares... in lieu of $35,000" and "that certainly is one piece of proof as to the value then placed by the parties on those 70,000 shares." (12/8/75 Tr. 5). The District Court rejected plaintiffs' contention and held that the "Fieland" transaction did "not provide persuasive proof of the fair market value of Trans stock" (A153). But instead, on its own initiative, after the trial and in its opinion, it found that defendant Fein should be liable for any proceeds or benefit he received from Fieland upon his delivery of the 70,000 shares. This claim was never alleged by plaintiffs and defendants did not have the opportunity to defend against it at the trial on the issue of damages in December 1975. Neither Fein nor Fieland testified on the subject at that trial since the issue was not raised.

At the trial on liability, the testimony related only to the fact that Fein delivered 70,000 shares to Fieland in August 1966. The testimony at that trial, held in September and October 1974, related only to the issue of liability. However, the issue of whether Fieland was accepting those shares in full satisfaction of his $35,000 claim or whether he had reduced his claim was not the subject of inquiry at that time since the issue of damages was not then before the Court.

The procedure followed by the District Court prevented

the defendants from presenting testimony and evidence to rebut a claim which was never presented by the plaintiff.

After conclusion of the trial, the District Court reviewed the transcript of the trial on the issue of liability held one year earlier, and concluded: "We find no significant evidence in the record which would indicate that Fieland was discounting his claim when he accepted the 70,000 Trans shares. If such was the case, the burden was upon Fein to establish what amount properly should be attributed to the Fieland transaction" (A156). Had defendant Fein been faced with this claim at the trial on the issue of damages, he would have proven, among other things, that "Fieland was discounting his claim." For, in pre-trial depositions, Fein testified "it is quite possible that I indicated that Mr. Fieland might be willing to compromise the amount of his claim for a lesser sum" and "I had offered Mr. Fieland some seventy thousand shares of Transcontinental Oil in settlement of his claims against Transcontinental Oil." (Fein depositions, pages 19, 30). Thus, if the issue were raised by plaintiffs at trial, it would have been heatedly contested by defendants.

The District Court's rather unorthodox procedure has resulted in an award of damages to plaintiffs upon a claim never asserted at the trial on damages. More importantly, defendants have been effectively precluded from presenting proof in opposition to that claim. Accordingly, and for all of the above reasons, the District Court's decision on damages should be reversed.

IV.

JUDGMENT SHOULD HAVE BEEN ENTERED IN FAVOR OF TRENTON AND FEIN ON THEIR COUNTERCLAIMS FOR PLAINTIFFS WRONGFUL REFUSAL TO PERMIT THE DEFENDANTS TO TRANSFER THEIR SHARES

A. The First and Second Counterclaims

The proof at trial established that upon assuming control of Transcontinental and in October, 1966 plaintiff Sackett caused Transcontinental to stop the transfers of all shares of stock in the name of defendant Trenton. After the shares were stopped, Sackett met with the defendants and asked for an explanation as to how Trenton had acquired the shares which it still held (Tr. 192-193). At that meeting, Sackett argued that "the deal was for all of the interests of... Trenton and Fein in Transcontinental that we were buying and that those shares ... should have been turned over to me as nominee as part of the agreement that we had to buy all of their interests in it." (Tr. 204-208).

When defendants refused to renegotiate their deal with Sackett and to give him any more shares above the 650,000 already delivered, Sackett used Transcontinental's corporate machinery to prevent the transfer of Trenton's additional shares and to advance his own personal ends. Defendants' First and Second Counterclaims seek damages resulting from the wrongful stop-order and the resulting conversion of their shares. In his decision, Judge Conner has, with the exception of the 100,000 Desilets shares, dismissed all of plaintiffs' attacks upon defendants'

right to the shares in their possession in October 1966. Thus, the Court has refused to deprive defendants of their ownership of the 550,000 shares which were the subject of the stop order and has awarded damages only with respect to the claimed conversion of the Desilets shares. Accordingly, the defendants have been improperly and wrongfully deprived of the ownership of their shares since 1966 and should be compensated therefor.

Under the Uniform Commercial Code a stockholder has a right to have the corporation in which he owns stock transfer that stock pursuant to his instructions. U.C.C. Sec. 8-401. The wrongful refusal to transfer shares of stock is a tortuous act which entitles the stockholder to an order compelling the transfer of the shares and for damages. Riskin v. National Computer Analysts, Inc., 62 Misc. 2d 605, 308 N.Y.S.2d. 985 (Sup. Ct. N.Y. Co. 1970), modified and affirmed, 37 A.D. 2d 952, 326 N.Y.S. 2d 419 (1st Dept. 1971); Gasarch v. Ormand Industries, Inc., 346 F. Supp. 550 (S.D.N.Y. 1972); Kanton v. United States Plastics, Inc., 248 F. Supp. 353 (D.N.J. 1965); Rothberg v. National Banner Corp., 259 F. Supp. 414 (E.D.Pa. 1966); 12 Fletcher Cyc. Corp. (perm. ed. 1971) § 5523, at 414 and cases cited therein.

In addition to Transcontinental's liability for the wrongs committed, Sackett, and those who acted in concert with him are also liable since "[i]t is a general principle that all persons who bid, command, advise or countenance the commission of a tort by another, or who approve of it after it is done, if done for their benefit, are liable therefor to the same extent as if

they committed the tort." 12 Fletcher Cyc. Corp. (perm. ed 1971) § 5524; Rothberg v. National Banner Corporation, supra (where, as here, the claim was made of a conspiracy between other stockholders and the corporation to prevent the transfer or sale of shares by claimant, which claim was found legally sufficient).

The burden of proof rests upon the plaintiffs to justify their actions in preventing the transfers (12 Fletcher Cyc. Corp. (perm. ed. 1971) § 5527, at 428) and they have failed to carry that burden.

A conversion is the "unjustified exercise of dominion over property by one who is not the owner of the property and who is not entitled to possession of the property which interferes with the right to possession of another who is lawfully entitled to such possession". Citizens National Bank v. Osetek, 353 F. Supp. 958, 963 (S.D.N.Y. 1973) and cases cited therein.

In a conversion action, "the defendants' knowledge, intent, motive, mistake, and good faith are generally irrelevent" Morissette v. United States, 342 U.S. 246, 270 (1952) and cases cited therein; Aeroglide Corp. v. Zen, 301 F. 2d 420 (2d Cir.), cert. denied, 371 U.S. 822 (1962).

Plaintiffs thus dealt with defendants' property at their peril and they, and not the defendants, must take the risk that there was no lawful justification for their acts.

Judge Conner totally ignored the law of conversion. In his opinion, he concluded that in order to recover on their counterclaims for conversion, defendants were required to prove that plaintiffs were motivated by bad faith (A142):

> "In this case, a number of claims were made, some by Sackett and his group and some by the corporation itself. Although the claims asserted were, with a single exception, rejected, plaintiffs [sic] have failed to prove that the stop order was motivated by bad faith."

For ten years, from October 1966 to the date of this appeal, plaintiffs prevented defendants from selling shares of stock which defendants rightfully own. Judge Conner, ignoring the substantial damage caused to defendants, concluded that since defendants failed to prove that the plaintiffs acted in "bad faith", the losses resulting from plaintiffs acts must be borne, not by the plaintiffs, but by the defendants.

Thus, the converters, who under the law are deemed to have proceeded at their peril, are not punished. Instead, the defendants must suffer the consequences and damages resulting from plaintiffs' wrongful acts. This is neither fair nor equitable. More importantly, Judge Conner's decision is contrary to the basic law of conversion and should be reversed.

It is apparent from the undisputed facts that Sackett, for his own personal benefit, used his power over the corporate machinery of Transcontinental to stop the transfer of defendants' shares. Sackett caused Transcontinental to stop the transfer of shares which he knew were rightfully acquired by Trenton in 1960 but which he claimed should have been delivered to him when he acquired control of Transcontinental.

The stop order was directed against the stock certificates which derived from the Anglo-Trenton shares (150,000 shares represented by certificates B6714 through B6716, B6718 through B6721, B6723 through B6735 and B6735 and B6736) and which Trenton had received from Anglo-Pacific as part of the Sedalia transaction.

In the trial below Transcontinental made no claim to those 150,000 shares. Thus, as between the company and the defendants, there existed no dispute as to defendants' rights of ownership to the Anglo-Trenton shares (A91).

Accordingly, the only reason which could be urged for the stop placed against those shares is that Sackett felt he was entitled to receive "all" of Trenton's shares under the agreement of June 22, 1966. The Ninth Count of the complaint brought by Sackett for breach of contract for Trenton's failure to deliver "all" of its shares to him was dismissed by Judge Conner as devoid of merit. Accordingly, as to the 150,000 Anglo-Trenton shares which were stopped, Transcontinental made no claim, and Sackett's claim thereto was dismissed. Thus, defendants were deprived of the use of those 150,000 shares of stock since 1966. Moreover, Transcontinental never required Sackett to post an indemnity bond for the damages defendants might suffer if Sackett's "adverse claim" failed.

With respect to all of the other Transcontinental shares in Trenton's possession in October 1966 (excepting the Desilets shares), Judge Conner refused to sustain plaintiffs' claim that those shares had either been wrongfully converted from Transcontinental or should have been delivered to Sackett.

In a similar case, Kanton v. United States Plastics, Inc., 248 F. Supp. 353 (D.N.J. 1965), the dominant shareholder of a corporation, one Scharps, had caused that corporation to refuse to transfer the shares of plaintiff. The corporation's defense to plaintiff's motion for a mandatory injunction to compel the

transfer was that Scharps had asserted an "adverse claim" and had commenced litigation against plaintiff with respect thereto. In rejecting the defense and directing the transfer of plaintiffs' shares, the Court stated at p. 363:

> "...the issue before this Court, as previously pointed out, is limited to a determination of plaintiffs' right to have a transfer of his stock registered on the books of Plastics. Whether or not Scharps can establish his claim to that stock as against plaintiff in some other proceeding is another matter, with which this Court is not presently concerned."

In ruling for the plaintiff, the Court noted that a corporation may only refuse, "for some reasonable period of time" to register a transfer of stock when an adverse claim thereto is made (248 F. Supp. at 362-363, emphasis added).

The Court recognized that under UCC8-401 a corporation has a mandatory duty to register the transfer of stock. In Kanton, as in this case, the corporation took no steps to relieve itself of that duty (248 F. Supp. at 362):

> "Plastics took absolutely no steps under the Code to relieve itself of the mandatory duty to register the transfer of plaintiff's stock. If it can be said that Plastics was under a duty to inquire into the Scharps claim before permitting the transfer of plaintiff's stock to be registered, an assumption not at all warranted by the facts in this case, it could have discharged such duty of inquiry by notifying Scharps that the transfer would be registered unless within the thirty-day period allowed by the Code, Scharps obtained a restraining order or put up an indemnity bond. Plastics did nothing in this regard. Instead, it was content to be made a party defendant in the Florida litigation, and to join with Scharps in that action in an effort, which proved unsuccessful, to prevent any change in the record ownership of plaintiff's stock. Aside from other considerations, mention of which will be made later in this opinion, it is clear that if the Uniform Commercial Code is deemed to be applicable to the facts of this case, Plastics is under a duty to register the transfer of plaintiff's stock."

Here, as in the Kanton case, the corporation and Sackett took no steps to relieve the corporation of its mandatory duty to register Trenton's shares. Plaintiffs have not "obtained a restraining order or put up an indemnity bond." Instead, they have applied self-help to stop the transfer of shares which the defendants have been found to rightfully own. For ten years Transcontinental has refused to permit the transfer of defendants' shares. In the interim, it and Sackett have done nothing more than to prosecute their suit. They have sought no injunction and posted no bond to indemnify the defendants for damages resulting from plaintiffs' acts. On the basis of the well-reasoned opinion in the Kanton case, and the many authorities cited therein, Transcontinental and Sackett should be found liable for their wrongful conduct and to compensate defendants for the damages which have resulted from their acts.

For all of the foregoing reasons, defendants are entitled to judgment on their first two counterclaims and to a trial on the issue of compensatory and exemplary damages.

B. The Third Counterclaim

Defendants Trenton and Fein have brought the third counterclaim against plaintiff Sackett and against the additional defendants who were joined in the action and who are the persons on behalf of whom Sackett acted in contracting with Trenton to acquire the 650,000 shares of Transcontinental stock. The claim is based upon Section 10(b) of the Securities and Exchange Act of 1934 and Rule 10(b)5, promulgated by the Securities and Exchange Commission under the said Act. Defendants Trenton and Fein

established at trial that Sackett and the additional defendants wrongfully prevented the defendants from selling their shares of Transcontinental, while at the same time selling off their own shares in the open market. The sales of the additional defendants total some 174,668 shares. (Defendants' Exhibits EEE, FFF, SSS, XXXX, ZZZZ, AAAAA, FFFFF and GGGGG). In addition, during that same period of time and between 1967 and 1972, Transcontinental issued many millions of shares of unregistered stock, while the price of the stock (after a 1 for 4 reverse split) rose to $11 per share (Ex. UUUU and page 4 of 1969 Annual Report). This all occurring at a time when the company's cumulative losses totalled $1,369,039 during the period and the company had a tangible net worth of 3¢ per share* (Ex. UUUU). The financial interest of both Sackett and the company in keeping Trenton's shares off the market thus becomes obvious.

The wrongful prevention of sales by stockholders who are selling their own shares and engaged in a massive distribution is both a violation of Section 10(b) and tortuous conduct. Mariash v. Morrill, 496 F.2d 1138 (2d Cir. 1974); Rothberg v. National Banner Corporation, 259 F. Supp. 414 (E.D.Pa. 1966).

Judge Conner's conclusion that defendants failed to prove a securities violation totally ignores the uncontroverted facts proven at trial.

In October, 1966, within weeks after control of Transcontinental and its transfer records were turned over to him,

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* Plaintiffs apparently went to such lengths to rig the market in the stock that the company's own auditors felt constrained to disclose that the unregistered shares might have been issued in violation of law and made the company potentially liable for civil and criminal wrongs (Ex. UUUU, especially footnotes 8 and 12 to financial statements contained in 1971 and 1972 annual reports respectively.)

Sackett stopped the transfer of all of Trenton's shares. Thus, Trenton was then unable to sell its remaining shares. At the same time and between October 1966 and up to the present, while efforts to block Trenton's sale of its shares continued the additional defendants sold off 117,610 shares (See plaintiffs' post-trial answering brief, p. 18-19) and Transcontinental issued millionsof new and unregistered shares.

The additional defendants' wrongful use of Transcontinental's corporate machinery to advance their own personal ends, by preventing Trenton's sales, compels the inescapable conclusion that the additional defendants violated Section 10(b) of the Securities and Exchange Act of 1934 and Rule 10(b)5 promulgated thereunder. Mariash v. Morrill, 496 F.2d 1138 (2d Cir. 1974); Rothberg v. National Banner Corp., 259 F. Supp. 414 (E.D. Pa. 1966).

Finally, it is undisputed that Sackett sought to keep the identity of those upon whose behalf he acted a secret. Why? What was he hiding? He knew that Fein and Leslie had a dispute in the early 1960's, and that Leslie's close association with convicted stock swindler Lowell Birrell was another reason why Fein refused to deal with Leslie. Notwithstanding, Sackett contacted Fein, at Leslie's behest, but without disclosing his association with Leslie, obviously fearing that Fein would not deal with him had he known of Sackett's relationship to Leslie. When the transaction with Trenton was being finalized, Fein specifically asked Sackett whether Leslie was in any way related to the group acquiring control from Trenton and Sackett answered

in the negative (Tr. 620-621). This was obviously a fact which was important to Fein in view of his prior poor relations with Leslie, which dated back to 1961 when Leslie urged Fein to reinstate Burkinshaw in control of Transcontinental. Throughout the trial, it was obvious to all that because of the animosity that had built up, Fein would not have dealt with Leslie under any circumstances and would not have made the deal with Sackett. Leslie's involvement was thus a material fact which was not disclosed to Fein and which was kept from him even when he asked. It is apparent that this material fact was deliberately withheld from Fein for fear that he would not permit the sale by Trenton of its shares. A more obvious material misrepresentation cannot be imagined under the facts of this case. Indeed, once ensconced in control of Transcontinental, Sackett, Leslie and the rest of the group engaged in the massive stock manipulation discussed above. The damages which Trenton subsequently suffered by reason of its inability to sell its shares directly flows from the wrongs of the additional defendants. The District Court's refusal to grant judgment on the Third Counterclaim is contrary to the uncontroverted evidence, is clearly erroneous and should be reversed.

CONCLUSION

The judgment entered on the Second Count in the amount of $48,200, with interest, should be reversed and the Second Count should be dismissed. The judgment dismissing the First

Second and Third Counterclaims should be reversed and remanded to the District Court for a trial on the issue of damages.

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Service of three (3) copies of the within

is hereby admitted this 6 day of

Dec 19 76.

Kaufman Taylor Kirby & Hilley

Attorney for